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TAGS: EFIN ECON ETRD EINV UK
SUBJECT: HMG SAYS UK WILL NOT INTRODUCE BANK LEVY TO RECOUP BAILOUT COSTS NOR FORMALLY SEPARATE BANKS

LONDON 00000260 001.3 OF 003

¶1. (SBU) Summary: Following President Obama's proposals for a Financial Crisis Responsibility (FCR) fee and bank restructuring, HMG announced it would not introduce similar measures in the UK. While HMG supports the concept of a future internationally coordinated global bank insurance levy, it does not anticipate the need for such a levy to recoup bail-out costs. HMT anticipates making a positive return for the taxpayer in recouping bail-out costs in the UK by selling its bank shareholdings "when the time is right." HMG would not emulate the U.S. "scope and scale" proposals by barring banks from proprietary trading and ownership of hedge and private equity funds, nor cap their size, but would seek to control risky bank behavior through enhanced capital requirements and more effective regulation. In contrast, both the Conservative and Liberal Democrat parties quickly announced their support for a permanent, worldwide version of the FCR and both welcomed U.S. scope and scale proposals - contingent on an international agreement. Financial services industry officials widely acknowledged the appropriateness of a bank levy in the U.S. to recoup costs, but argued that institutions that had not accessed or benefited from TARP should be charged at a reduced rate. They argued against the introduction of the scope and scale proposals in the UK. End Summary.

HMG: No Need for Bank Levy or U.S. Style Restructuring

¶2. (SBU) The UK is not considering adopting a levy on banks to repay taxpayers for the bank bailouts. In a newspaper interview January 16, Chancellor Darling said the British government had organized its bank rescue differently than the U.S. by buying shareholdings and implementing credit guarantees, rather than buying the banks' toxic debts. As such, rather than recover this money through a bank levy, HMG expected to turn a profit by selling its bank shares - in Northern Rock, Royal Bank of Scotland, and HBOS - "when the time is right." HMG's response to the U.S. bank levy was muddied when media commentators reported on January 18 that Lord Myners, Financial Services Secretary, had suggested there could be a UK-wide levy on banks. The Prime Minister's spokesman quickly clarified that Lord Myners had said he was convening a meeting on January 25 to look at the "very broad principles" of systemic resolution funds. The spokesman said a U.S.-style bank levy to recoup bailout costs was unnecessary because the UK had a different pay-back option, through the sale of shares. However, he noted that the Prime Minister had been the first to bring up the possibility of a global transactions tax and separately, an insurance levy, and that the G20 had referred these options to the IMF for review. HMT Managing Director for International and Finance Michael Ellam reiterated this point to EMIN. Ellam said HMT supported the concept of a future global bank insurance levy. He would have liked to see the U.S. coordinate more closely with international partners on the fee, but acknowledged that tax policy is a sovereign prerogative.

¶3. (U) HMG does not support U.S. proposals to cap the size and trading activities of banks. In a January 28 interview prior to his trip to Davos for the World Economic Forum, Chancellor Darling said: "I have always thought to separate banks doesn't deal with the full problem...It is the connections between institutions that cause problems, not the legal entity. The large bank/small bank division - experience shows - does not answer the question of Lehmans." He added that greater global coordination is needed to avoid regulatory arbitrage and concluded: "The Americans want radical reform, I want radical reform. The key though is that we move from that discussion to implementation of something that is effective and we do it without delay." Financial Services Secretary Lord Myners said the U.S. proposals responded to the "idiosyncratic problems" in the U.S. banking system which centered on investment banking. In the UK, he argued, proprietary trading, hedge funds, and private equity were not at the heart of difficulties in Northern Rock, the Royal Bank of Scotland or HBOS.

¶4. (U) While HMG was dismissing introduction of similar proposals in the UK, Bank of England Governor Mervyn King reiterated his support for separating retail banks from investment banks. (Note: King had called for Glass-Steagall-type legislation in the UK throughout the financial crisis as a way to prevent moral hazard.) Appearing before the House of Commons' Treasury Select Committee on January 26, King said: "Banks who think they can do everything for everyone all over the world are a recipe for concentrating risk." Instead, he argued, the banking sector should be made up of more, smaller participants that specialize in different activities. Further, he argued, international lenders should be carved up into national subsidiaries each with its own reserves to build firewalls across the banking system and stop massive losses spreading.

Opposition: Want Insurance Fee, Restructuring Plans - But Must be Global

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¶5. (U) Shadow Chancellor George Osborne said a Conservative government would welcome the introduction of a permanent, worldwide version of the U.S. Financial Crisis Responsibility fee. He said a Tory administration would support a bank levy to protect taxpayers from the costs of a future crisis as long as it was agreed by G20 countries. His comments were echoed by Mark Hoban, Shadow Financial Secretary, during a January 20 conference hosted by the Institute for Public Policy Research (IPPR). Hoban caveated that a financial levy would only work if it was coordinated at a global level. An international agreement would be needed, he reiterated, saying the UK could not move forward with this idea on a unilateral basis.

¶6. (U) George Osborne showed similar support for U.S. bank restructuring proposals. In an interview on BBC radio January 22, Osborne said: "By saying what he has said, President Obama is creating a lot of space for the rest of the world to come up with new systems of regulation" and added that Tories were in favor of "Obama-style regulation of the structure of banks." He said, however, that Conservative support was contingent on getting an international agreement on restructuring. In Davos on January 28, Osborne clarified the Conservative position further. He said while the Tories favored scope and scale proposals, they would not back strict Glass-Steagall-type separation of retail from investment banks. They understand the need of most universal banks to offer their customers investment banking services. They would seek to prevent banks from engaging in the riskiest activities through tighter regulation.

¶7. (U) The Conservative Party highlighted HMG's lack of support for U.S. proposals during Prime Minister's Questions in the House of Commons on January 27. William Hague, the Tory Shadow Foreign Secretary who was standing in for party leader David Cameron, asked Harriet Harman (standing in for the Prime Minister) why the government had not supported President Obama's proposals enthusiastically and was not working with him to realize them. He further pushed Harman on HMG's lack of support for the U.S. levy. He said there is a clear case for a levy to compensate taxpayers for

what happened in the past and what may happen in the future. He added that it is time to work with the President on agreeing the proposed levy, while dropping the idea of a Tobin tax on transactions, which, he argued, had been rejected throughout the world and had been ridiculed by Governor Mervyn King. Harman responded by stressing the importance of coordinating action internationally and said the UK is working closely with the President. She noted, however, that the U.S. has different structures and different problems in its banking system.

¶8. (U) The Liberal Democrats supported the U.S. bank levy proposal, saying the U.S. had "grasped the scale of the problem." Vince Cable, the Liberal Democrats' Treasury spokesman, said if banks continued to rely on taxpayer guarantees, they should pay for it. In comparison, he criticized Labour's tax on bonuses for failing to change the "irresponsible practices which did so much to get us into this mess." Cable, who has consistently called for the introduction of Glass-Steagall-type legislation, praised the President's proposals. In a speech January 25 to think-tank Demos, Cable said: "Now that President Obama has taken on the issue of breaking up the banks on his side of the pond, it is time we do the same in the UK. I see, at present, no evidence that the government or the Conservatives have any vision of banking beyond the immediate crisis."

Industry Response: U.S. Levy Has "Intellectual Credibility"
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¶9. (SBU) The British Bankers' Association (BBA) understands that the levy provides a means by which the U.S. taxpayer can reclaim money lost through the bank bail-out. However, Paul Chisnall, Executive Director of Financial Policy at the BBA, told us he sees no need for equivalent action in the UK because bank intervention here was on a different basis. On the U.S. levy, Chisnall said he sees a case for introducing a reduced premium for foreign banks in the U.S. not given direct access to the TARP (such as HSBC, Barclays and RBS). On U.S. proposals to restructure banks, Chisnall told us that the BBA very much supported Lord Myners' view that problems in the UK banking system differ from those in the U.S., and so require different responses.

¶10. (SBU) Europe has the universal banking model embedded in its history and is unlikely to adopt plans to split banks, according to bankers at an Embassy-organized bank roundtable January 22. The bankers told us the UK needs to take particular care about adopting banking reform measures without adequate consultation with industry because of its heavy reliance on financial services, which account for approximately 8 percent of GDP and 14 percent of tax revenue.

They argued that HM Treasury is arrogant to assume businesses will stay in the UK if overly restrictive reforms are adopted, because it is so easy to book their business elsewhere.

¶11. (SBU) UK based analysts expect three UK banks to be impacted by the fee. Joseph Dickerson, an analyst at brokerage firm Execution, expects HSBC to owe $3.8 billion over ten years, Barclays $5.6 billion and RBS $1 billion. A contact at RBS told us that the proposed U.S. levy is not a bad thing; indeed, it is the best proposal yet. He said the levy is more coherent than any other proposals brought forward and has "intellectual credibility." The UK bonus tax, by comparison, is a tax on individuals and institutions the government has singled out for political gain. A senior official at the Confederation of British Industry echoed these comments.

UK Academics: Fee is Good, but Could Be Even Better
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¶12. (U) During a January 20 conference, Professor Charles Goodhart from the London School of Economics supported the fee as superior to the UK bonus tax, but said the U.S. levy could be improved if it was related to the maturity of a firm's debt. He argued that firms with large amounts of short term debt should be charged higher fee rates, because of the inherent riskiness, while firms holding long-term debt should be charged at lower rates. In this way, he argued, the

fee could improve the way banks function.

¶13. (U) Other UK-based academics have been more critical. Keith Young, a professor at the London School of Economics, said neither the U.S. levy, nor the UK bonus tax, would lead to wider reform of the financial system. He said it is inevitable that many banks and their associations won't like the levy, but ultimately it is a very minor measure to recoup funds, not an ambitious plan for reform. Professor Keith Pilbeam at City University praised the plan for spreading payments over 10 to 12 years but said it failed to address the central issue. He said the market failure is banking pay, shown this year when share prices are down but pay and bonuses are still high. He said something more needs to be done to address this failure, perhaps even pay caps through legislation.

¶14. (SBU) Comment: UK responses to U.S. banking proposals have been mixed. However, one strain of criticism was particularly pronounced at the outset - that the U.S. should not have proceeded unilaterally, outside of the G20. This critique has been tempered over the past week by prominent expressions of support for the U.S. initiatives, which acknowledge that the proposals are furthering the debate on financial regulation in the aftermath of the crisis.

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